TRUST GUIDANCE FACT SHEET NO. 1

SECTION 100A REIMBURSEMENT AGREEMENTS

TR 2022/4 and PCG 2022/2

Overview of how the ATO proposes to differentiate risk for trust arrangements to which section 100A may apply and recommendations for managing and mitigating any actual risk in practice

Updated: December 2022

CPA AUSTRALIA

Introduction

This guidance will assist CPA Australia members to understand the issues arising from the ATO guidance on section 100A reimbursement agreements and the positions taken by the Commissioner of Taxation.

This fact sheet provides an overview of each of the risk zones contained in PCG 2022/2 and covers:

- Types of arrangements in each zone
- The ATO's compliance approach
- Options to consider
- Recommendations for action.

Taxation Ruling TR 2022/4 Income tax: section 100A reimbursement agreements (TR 2022/4) and *Draft Practical Compliance Guideline PCG 2022/2 Section 100A reimbursement agreements - ATO compliance approach* (PCG 2022/2) set out how the ATO categorises risk and allocates compliance resources to perceived risks associated with section 100A of the *Income Tax Assessment Act 1936* (section 100A).

The views expressed by the ATO are to apply to all trust entitlements conferred after 1 July 2022. For trust entitlements conferred before 1 July 2022, the ATO will stand by any administrative position reflected in Trust Taxation – reimbursement agreement first released in July 2014, to the extent that it is more favourable to the taxpayer's circumstances.

PCG 2022/2 contains four risk categorisation zones – white, green and red – with corresponding differentiated ATO compliance approaches and different responses required from taxpayers and advisors.

The ATO has stated that:

- A distribution to an adult child who has a low marginal tax rate will not attract section 100A where they simply receive or otherwise enjoy the benefit of their distribution
- The ATO will stand by its previous guidance for arrangements entered between 1 July 2014 and 30 June 2022 for those taxpayers who relied on it
- In most cases, the ATO will only apply section 100A within 4 years of a trustee lodging their tax return
- The ATO will not be reviewing arrangements prior to 1 July 2014, other than in exceptional circumstances as outlined in the guidance.

The information contained within this fact sheet can be considered when contemplating trust arrangements. However, it is important to note that each situation will be different, and the fact sheet is not a substitute for independent legal advice.

This information is based on the guidance as at 9 December 2022.

White zone

Arrangements and approach

Arrangements

- Arrangements entered into prior to 1 July 2014 and not ongoing after 2014.

Compliance approach

- Considered low risk - direct compliance resources will not be applied to such arrangements
- May be considered where the ATO is generally considering the affairs of the taxpayer or returns for the trust have not been lodged before 1 July 2017.

Options and recommendations

Historic risk

- Check tax return lodgement dates for years before 1 July 2014
- If tax returns were lodged after 1 July 2017 and taxpayer is currently subject to review by the ATO, address as you would for the greenor red zones if it were in a later income year
- If tax returns were lodged after 1 July 2017 and taxpayer is not currently subject to review, ensure documentary records that are relevant to issues are retained for period the years that remain open to review.

For advisors

- Review records to identify taxpayers for whom tax returns for years before 1 July 2014 were lodged after 1 July 2017
- Inform those clients of their position and available options.

Green zone

Arrangements and ATO compliance approach

Arrangements
• The ATO will not dedicate compliance resources to consider the application of section 100A to a range of green zone arrangements, all of which are subject to exclusions set out in paragraph 32 of PCG 2022/4
• Caution should be taken to ensure that arrangements satisfy the PCG requirements and that facts and circumstances are consistent with the relevant scenario
• Green zone scenarios cover:
– Distributions to individuals who are members of a family (scenario 1)
– Funds used for family purposes (example 4)
– Distributions from a family business (example 8)
– Beneficiary's entitlement received and used by the beneficiary (scenario 2)
– Retention of funds by the trustee for an individual beneficiary (scenario 3A)
– Retention of funds by the trustee for a company or trust beneficiary by way of a loan on commercial terms (scenario 3B)
– Trustee retains funds and services loan agreement (example 12)
– Distributions to a company beneficiary with tax losses (example 13)
– Use of funds condition and part-payment of unpaid present entitlement (example 7)
– Use of funds condition and unpaid present entitlement (example 11)
– Time lag between a beneficiary becoming presently entitled and that entitlement being satisfied (example 5)
– Time lag between a loss trustee beneficiary becoming presently entitled and that entitlement being satisfied (example 6)
– Examples described in Appendix 2 of TR 2022/4 as being an ordinary family or commercial dealing (scenario 4) including:
  – Trust established under a will
  – Distribution to spouse with mixed finances
  – Gifts from parents to a child
  – Unpaid entitlements held on trust
  – Non-commercial loan between family members.
– Distributions involving a trustee undertaking a farming business (example 9)
– Testamentary trust (example 10).

Compliance approach • Considered low risk • Direct compliance resources will not be applied to such arrangements but may be considered where the ATO is generally considering the affairs of the taxpayer.

Options and recommendations
Historic and future tax risks • Ensure documentary records relevant to issues are retained for period the years remain open to review. • These records should contain sufficient detail to satisfy the ATO that the arrangement is green zone and may include: – trust distribution minutes – trust deeds – employment records – bank account records – financial statements for the trust – section 109N loan agreements.
For advisors • Review records and ensure those relevant to the issues are retained for the retention period • Notify clients of existence of guidance products and of their options/obligations to retain records • For future years: – Meet with clients to discuss objectives and rationale and ensure that is documented – Advise clients that the ATO could ask what they intend to use funds for and that it will be a potential problem if the funds are to be loaned or gifted to related parties and applied against an existing loan – Best practice to protect an advisor's position would be to attain authorities from each of the advisor's client/s, the trustee and the beneficiaries as to how funds are to be distributed.

Red zone

Arrangements and ATO compliance approach

Arrangements

- Where entitlements appear to be motivated by the aim to shelter the trust's taxable income from higher rates of tax
- Arrangements that involved contrived elements aimed to allow somebody other than the beneficiary to use the entitlements
- Examples include arrangements where the:
  - presently entitled beneficiary lends or gifts some or all of their entitlement to another party (red zone scenario 1)
  - trust income is returned to the trust by the beneficiary in the form of assessable income (red zone scenario 2)
  - presently entitled beneficiary is issued units by the trustee (or related trust) and the amount owed for the units is set off against the beneficiaries' entitlement (red zone scenario 3 and example 16)
  - share of net income included in a beneficiaries' assessable income is significantly more than the beneficiaries' entitlement (red zone scenario 4 and example 17)
  - presently entitled beneficiary has losses and is outside the family group (red zone scenario 5 and example 18)
  - arrangements subject to a Taxpayer Alert (e.g., *TA 2022/1 Parents benefitting from the trust entitlements of their children over 18 years of age*) (red zone scenario 6)
  - amounts provided to the parent in respect of expenses incurred before the beneficiary turns 18 years of age (example 14)
  - non-resident beneficiary makes a loan or gift to another party (example 15).

Compliance approach

- Considered high risk
- Will attract ATO scrutiny.

Options and recommendations

Historic risk

- Ensure documentary records that are relevant to issues are retained for period the years remain open to review – these are broadly the same as for green zone arrangements
- Depending on the degree of certainty desired by the taxpayer, options for advisors include:
  - Provide advice
  - Seek further advice including legal opinion
  - Wait and watch. However, if the ATO commences compliance action and determines section 100A applies, penalty tax of up to 90 per cent could be imposed
  - Voluntary disclosure of relevant facts. This includes how the arrangement has been assessed against the PCG and the possibility of section 100A applying. This can reduce penalty exposure by up to 80 per cent without requiring taxpayer to admit their position is wrong, provided the voluntary disclosure is complete.

Future risk

- Ensure documentary records that are relevant to issues are retained for period the years remain open to review
- Consider trust distribution minutes (or other written record) including rationale for why the trustee is distributing income as it is
- If a taxpayer disagrees with the views expressed by the ATO and wants to challenge the position, consider a private ruling or lodging in accordance with the ATO position and then self-objecting.

For advisors

- Review records and ensure those relevant to the issues are retained for the retention period
- Notify clients of existence of ATO guidance products and their options
- For future years:
  - Meet with clients to discuss objectives and rationale and ensure that is documented
  - Advise clients that the ATO could ask what they intend to use funds for and that it will be a potential problem if the funds are to be loaned or gifted to related parties and applied against an existing loan
  - Best practice to protect an advisor’s position would be to obtain authorities from each of the advisor’s client/s, the trustee and the beneficiaries as to how funds are to be distributed.

About the author

This checklist was prepared by Holding Redlich on behalf of CPA Australia and updated by CPA Australia.